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Sevilleja v Marex Financial Ltd: Reflective Loss and the Autonomy of Company Law

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In *Sevilleja* v *Marex Financial Ltd* the Supreme Court considered the ambit of the prohibition on a shareholder recovering losses from third parties for the reduction in the value of their shares or loss of dividend income arising from a wrong suffered by the company. This prohibition on 'reflective loss' had been growing in scope in recent years, leading to a lack of clarity as to whether it is taxonomically situated in company law or in private law. The majority in this case situated the prohibition firmly within company law. This note argues that the majority judgment did not go far enough and explores the impact of this case on company law more broadly.

INTRODUCTION

'Reflective loss' is a company law[1] term for resulting loss suffered by shareholders when a company suffers a wrong. It can manifest by reduction in the value of shares or reduction in the dividend income caused by this wrong.[2] Company law has long held that the company is the correct party to sue for a wrong done to it (and therefore the shareholders are not).[3] Similarly, it has held that shareholders are prohibited from recovering reflective loss.[4] This principle will be referred to as "the prohibition" throughout this case commentary. The extent of the prohibition, however, was not clear. Three key issues were unresolved. First, the boundaries of the prohibition were unclear: whether it only affects shareholders, or equally applies to other constituencies.[5] Second, whether the

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1 We use the term 'company law' widely in this case commentary, to include all business organisations. It has been correctly pointed out that a number of authorities in this field do not arise in the context of companies, but in the context of other forms of legal entities such as trade unions – see P.L. Davies, 'Reflecting on "Sevilleja v Marex Financial"' Oxford Business Law Blog, 5 August 2020 at https://www.law.ox.ac.uk/business-law-blog/blog/2020/08/reflecting-sevilleja-v-marex-financial (last accessed 7 May 2021).
2 See G. Morse et al, *Palmer's Company Law* (London: Sweet & Maxwell, Release 168, 2020) para 8.3719; P.L. Davies and S. Worthington, *Gower Principles of Modern Company Law* (London: Sweet & Maxwell, 10th ed, 2016) paras 17.34-17.38.
3 *Foss* v *Harbottle* (1843) 2 Hare 461.
4 *Prudential Assurance Co Ltd* v *Newman Industries Ltd (No 2)* [1982] Ch 204.
5 *Gardner* v *Parker* [2004] EWCA Civ 781, [2004] 6 WLUK 502; B. Hannigan, 'Drawing boundaries between derivative claims and unfairly prejudicial petitions' [2009] *Journal of Business Law* 606; P.W. Lee, 'Creditors' claims for reflective loss' [2008] *Journal of Business Law* 479; J. Mukwiri, 'The no reflective loss principle' (2005) 26 *The Company Lawyer* 304.

prohibition meant that the shareholder is deemed to suffer no loss, or whether the shareholder suffers loss but is prohibited from recovering it. Third, the link between the prohibition and wider private law remedies was uncertain – whether it is a discrete part of company law, or whether it is based on wider English law principles for remedies in respect of a concurrent wrong.[6]

These questions have been answered by the Supreme Court in *Sevilleja* v *Marex Financial Ltd*[7] (*Sevilleja*). Here, the issue was whether the prohibition also applied to loss suffered by creditors, and if not then why not. This case commentary discusses the case and the three judgments issued, then explores two aspects of its wider implications. First, it explores implications for the prohibition. Second, it explores wider company law implications.

THE CASE AND ISSUES

The case concerned two BVI companies. Both were controlled by Sevilleja, who also ultimately owned the shares in them. Sevilleja disputed the facts accepted by the court.[8] These facts were that Sevilleja used these companies to trade in foreign exchange. Both companies entered into contracts with Marex. In 2013, Marex obtained English judgments against these two companies for US$5.5m, plus costs of £1.65m. The judge sent all parties a confidential draft judgment on 19 July 2013, and formalised the orders for payment on 25 July 2013. Starting on 19 July 2013, Sevilleja procured that the two companies alienated US$9.5m to accounts that he controlled. As at the end of August 2013, the aggregate total gross assets of both companies was under US$5,000. These alienations were said to have the express object of preventing Marex from receiving any funds due under the judgment, and breached duties owed by Sevilleja to the companies.

In December 2013, Sevilleja put both companies into insolvent liquidation. The companies owed over $30m to parties related to Sevilleja. Marex was the only non-insider creditor. The liquidator had not taken any action against Sevilleja for these breaches. A US court held that the liquidation was merely 'a device to thwart enforcement' of the English judgments, and that Sevilleja controlled the BVI liquidator.[9] Marex therefore sued Sevilleja in tort for, amongst other things, intentionally causing it to suffer loss by unlawful means. Sevilleja admitted that some of the costs claimed against him did not fall under the prohibition. However, he argued that some of Marex's loss as creditor of the

6 See C. Mitchell, 'Shareholders' claims for reflective loss' (2004) 120 *Law Quarterly Review* 457; A. Tettenborn, 'Creditors and reflective loss – a bar too far?' (2019) 135 *Law Quarterly Review* 182; P. Watts, 'Marex Financial Ltd v Sevilleja: Some Commentary in Response to Paul Davies's Blog Contribution' Oxford Business Law Blog, 7 August 2020 at https://www.law.ox.ac.uk/business-law-blog/blog/2020/08/marex-financial-ltd-v-sevilleja-some-commentary-response-paul-daviess (last accessed 7 May 2021).

7 *Sevilleja* v *Marex Financial Ltd* [2020] UKSC 31; [2021] AC 39.

8 *ibid* at [15].

9 *In re Creative Finance Ltd (In Liquidation) et al* United States Bankruptcy Court, Southern District of New York, 13 January 2016 (unreported), as quoted in *Sevilleja*, n 7 above at [20].

companies was purely reflective of the loss suffered by the companies, and as such fell within the prohibition. This was the issue before the Supreme Court: whether the loss caused to Marex qua creditor of the companies fell within the prohibition. This issue arises because case law has resulted in a dramatic growth of the ambit of reflective loss.[10] Three judgments were delivered in the case: Lord Reed (with whom Lady Black and Lord Lloyd-Jones agreed), Lord Hodge, and Lord Sales (with whom Lady Hale and Lord Kitchin agreed). Lord Hodge ultimately agreed with Lord Reed, but wanted to 'add a few comments about the central role of company law in the Court of Appeal's judgment in the *Prudential* case which is the *fons et origo* of the principle.'[11] We will refer to Lord Reed's judgment as the majority,[12] and Lord Sales' as the minority. All judgments agreed that Marex's qua creditor losses were not caught by the prohibition. As such, Marex could continue their claim. However, the reasoning for such outcome differed between judgments. To explore the different reasons, we need to trace the development of the prohibition.

The prohibition originated in *Prudential* v *Newman Industries*[13] (*Prudential*). There, a company's directors sold the company's assets to a third party at an undervalue. The directors then obtained shareholder ratification of the sale at a meeting convened on the basis of a circular which contained a fraudulent misrepresentation about the transaction. Prudential was a minority shareholder who brought a derivative claim against the company. The derivative claim allows a shareholder to pursue a claim against a wrongdoing director in the name of the company, with any recovery being received by the company rather than the shareholder.[14] It has been criticised as being inaccessible to shareholders, and of limited value even if successful.[15] As a fall-back option, in the event that their derivative claim was unsuccessful, Prudential also raised a personal action in respect of the loss in value of their shares arising as a result of the directors' wrong.[16] Prudential offered no evidence for this loss in addition to the evidence they provided for their derivative claim.[17] The Court of Appeal held that Prudential could not recover the loss of the drop in their value of shares, as

> the shareholder does not suffer any personal loss. His only 'loss' is through the company, in the diminution in the value of the net assets of the company, in which he has (say) a 3 per cent. shareholding. The plaintiff's shares are merely a right of participation in the company on the terms of the articles of association. The shares

10 See Tettenborn, n 6 above.
11 *Sevilleja*, n 7 above at [95].
12 Plurality has also, and potentially more accurately, been deployed – see S. Laing, 'Reflective loss in the UK Supreme Court' (2020) 79 *Cambridge Law Journal* 411.
13 n 4 above.
14 Companies Act 2006, ss 260-264; J. Armour, 'Derivative actions: a framework for decisions' (2019) 135 *Law Quarterly Review* 412; D. Kershaw, 'The rule in Foss v Harbottle is dead: long live the rule in Foss v Harbottle' [2015] *Journal of Business Law* 274.
15 For example, see A.M. Gray, 'The statutory derivative claim: An outmoded superfluousness?' (2012) 33 *The Company Lawyer* 295.
16 *Prudential*, n 4 above.
17 *Sevilleja*, n 7 above at [134] and [148].

> themselves, his right of participation, are not directly affected by the wrongdoing. The plaintiff still holds all the shares as his own.[18]

The judgment used an example of a company whose sole asset was £100,000 cash in a box. If a wrongdoer fraudulently obtains the key, and steals the money, the company suffers a loss, and any loss to the shareholder is merely their proportion of that loss. As such, there is no separate action for the shareholder.[19] This example has been heavily criticised as being artificial.[20] Nevertheless, *Prudential* laid the clear rule that shareholders could not recover for loss arising due to a drop in the value of their shares or a loss of dividend income where the company also had an actionable wrong. The origin of this rule, though, had two potential taxonomical groundings. First, that it arose because the company was the correct party to sue, and therefore descended from the company law rule of *Foss* v *Harbottle*[21] and second, that the issue was that the company and shareholder's claims overlapped. This approach rendered recovery of the shareholder's loss a double recovery from the wrongdoer, with policy reasons to prefer the company's claim over the shareholder's.[22] If the former, then the prohibition was a neat part of company law that arose for any interaction between shareholder loss and company loss. If the latter, then the prohibition was part of the wider private law of damages, and was only triggered where such loss was inherently overlapping and risked double recovery for the same wrong. Similarly, if the former, the shareholder has no cause of action; if the latter then the shareholder has a cause of action but is prevented from recovering it.[23]

The position became more complicated in *Johnson* v *Gore Wood*[24] (*Johnson*), where a company's solicitors were negligent in respect of a property owned by the company. Johnson owned 'virtually' all the shares.[25] Johnson sued for a number of heads, one being payments to Mr Johnson's pension policy which could not be paid by the company due to the solicitors' negligence. Lord Bingham identified three categories. First, where the loss is suffered by the company as a breach of a duty owed only to the company, then the shareholder cannot sue due to the prohibition on the recovery of reflective loss.[26] Second, if the company suffers loss but has no action, the shareholder can sue to

18 *Prudential*, n 4 above, 223.
19 *ibid*, 223.
20 Mitchell, n 6 above, 459; P. Koh, 'The Shareholder's Personal Claim: Allowing Recovery for Reflective Losses' (2011) 23 *Singapore Academy of Law Journal* 863, 866-867.
21 *Foss* v *Harbottle*, n 3 above.
22 M.J. Sterling, 'The Theory and Policy of Shareholder Actions in Tort' (1987) 50 MLR 468; J.L.S. Lin, 'Barring recovery for diminution in value of shares on the reflective loss principle' (2007) 66 *Cambridge Law Journal* 537.
23 Compare the position of the majority in *Sevilleja*, n 7 above at [80] with the position of the minority at [144].
24 *Johnson* v *Gore Wood & Co (No 1)* [2002] 2 AC 1, [2001] All ER 481; P. Watts, 'The shareholder as co-promisee' (2001) 117 *Law Quarterly Review* 388.
25 *Johnson ibid*, 56.
26 *Sevilleja*, n 7 above at [41]. This is based on *Heron International Ltd* v *Lord Grade* [1983] BCLC 244 and *Stein* v *Blake* [1998] 1 All ER 724.

recover reflective loss if they have an action.[27] Third, where the company and the shareholder suffer independent losses caused by independent breaches, both can sue.[28] In both judgments issued, recovery of the missed payments to Johnson's pension fund was caught by the prohibition. Confusion arises, though, from Lord Millett's judgment, which was based on discussion of double recovery.[29] If the issue is ultimately one of double recovery, then it is acknowledged that the shareholder has a claim, but there are restrictions on how that claim can be exercised. Such restrictions are justified as there is an established method for distributing assets of a company (both as dividends and on winding up) which would otherwise be circumvented by a single shareholder recovering that loss. Under this logic, these restrictions must, though, be limited to where shareholder recovery would cause double recovery.[30] As such, viewing the principle in the second taxonomical grounding, not all loss to shareholders arising from the diminution in value of shares will be caught by the prohibition. Lord Millett grounded his discussion in the context of shareholders.[31] However, his logic is not limited to shareholders – if the prohibition arises where (and only where) recovery of such loss risks double recovery, and such double recovery threatens diversion of assets away from the corporate fund[32] to one participant in that fund, then non-shareholder claims which cause the same issues should be subject to the same rule. If a wrong to a company resulted in a creditor not being paid by the company, then this logic must also apply to any claim that the creditor had against the wrongdoer. As such, Lord Millett's reasoning grounded the prohibition more fully in the general law of damages, providing taxonomic coherence with private law. However, this reasoning meant that the prohibition need not apply to all claims for reflective loss by shareholders, and could apply to non-shareholders.

These issues were exemplified in further cases – in *Giles* v *Rhind*[33] (*Giles*), an individual was a director of a company and a lead shareholder. A third party breached duties owed to the company and to the individual. The company could not afford to sue due to the breach, and so dropped their claim, but the individual was allowed to sue for all claims, including a loss of value of their shares, on the grounds that denying this would be 'unjust'.[34] Conversely, in

27 *Sevilleja ibid* at [41]. This is based on *Lee* v *Sheard* [1956] 1 QB 192; *George Fischer (Great Britain) Ltd* v *Multi Construction Ltd* [1995] 1 BCLC 260, and *Gerber Garment Technology Inc* v *Lectra Systems Ltd* [1997] RPC 443.

28 *Sevilleja ibid* at [41]. This was based on the cases cited above, but also *RP Howard Ltd* v *Woodman Matthews & Co* [1983] BCLC 117.

29 *Johnson*, n 24 above, 57, 62.

30 Lord Millett's argument was used in the case of *Peak Hotels and Resorts Ltd* v *Tarek Investments Ltd* [2015] EWHC 3048 (Ch); [2015] 9 WLUK 387 to argue that reflective loss did not apply where the company was not seeking damages but instead seeking an injunction against the wrongdoer – see *Sevilleja*, n 7 above at [53].

31 *Johnson*, n 24 above, 61-65.

32 S. Watson, 'The corporate legal entity as a fund' [2018] *Journal of Business Law* 467; S. Watson, 'How the company became an entity: a new understanding of corporate law' [2015] *Journal of Business Law* 120.

33 [2002] EWCA Civ 1428; [2003] Ch 618. See discussion in H.C. Hirt, 'Companies in general' [2003] *Journal of Business Law* 420.

34 The word unjust only appears in the majority opinion in *Sevilleja*, n 7 above at [69].

Gardner v *Parker*[35] (*Gardner*), a shareholder also held a right as a creditor, and bought the company's rights to claim against a wrongdoing shareholder and director. The court held that the prohibition applied in respect of debt owed to a shareholder. In obiter comments, Lord Neuberger added that the prohibition would also apply to an employee or creditor who was not a shareholder.[36] As a result of basing the prohibition in the second taxonomical grounding, reflective loss had morphed into something which at the same time did not apply to all shareholder claims, and now also applied to non-shareholder claims. As such, it became part of the law of obligations when interacting with a juridical person. Tettenborn stated that it 'promises to distort large areas of the ordinary law of obligations', akin to 'some ghastly legal Japanese knotweed.'[37]

In *Sevilleja* v *Marex*, the Supreme Court therefore had a narrow question before it and a wider question. The narrow question was whether Marex's relevant claim was caught by the prohibition – which all answered negatively. The wider question was, in either case, why. In particular, clarity as to the taxonomical grounding of the rule was required.

The Supreme Court had five ultimate options, three in the first taxonomical grounding and two in the second. First, on the strong company law approach – that the prohibition applied to all those interacting with a company – the rule comes from company law, but applies to all those interacting with the company. Thus the prohibition would catch employees, creditors, and tort victims of companies. This result is the extension of the *Gardner* result, and so causes Tettenborn's distortion. It is company law at its most muscular – interacting with a company, as a matter of company law, distorts your ordinary private law interactions. As such being a creditor, employee, or tort victim of a company is inherently different from being a creditor, employee, or tort victim of a sole trader. This option would bar Marex from claiming.

Second, on the semi-strong company law approach – that the prohibition applied to all claims held by shareholders – if a third party creditor held a debt, their recovery of it would not be affected by the prohibition, but if they sold that claim to a shareholder, then it would be. This also arises conceptually from company law, but holds that there is something inherent in being a shareholder of a company which can compromise all claims you have in respect of that company. This follows *Gardner* without extending it. As Marex is not a shareholder, under this option Marex would win.

Third, on the weak company law approach, in which the prohibition only follows shareholder claims qua shareholder, a transferred debt claim would not be caught by the prohibition, but a claim linked to the narrow areas of loss of value of shares, or loss of income in respect of shares, would be. This is also a matter for company law, but would strip back the law to the position outlined in *Prudential*. Once again, under this option Marex would win. Under any of these three routes, if the prohibition were triggered, it would preclude the relevant party having a claim against the third party as a matter of company law.

35 *Gardner*, n 5 above.
36 *ibid* at [70].
37 Tettenborn, n 6 above, 183.

Fourth, the strong private law approach would hold that the prohibition is a subset of the rule on double recovery which can apply to any corporate constituency. It would thus not be a company law matter at all – instead it is something that only arises when those interacting with the company have a double recovery. However, it applies to all interacting with the company, and not just shareholders. This is the extrapolation of Lord Millett's approach in *Johnson*. It presents a muscular form of private law, as there would be nothing company-specific about the rule, instead it would be a subset of the private law rules of double recovery. Thus, if the company pursued the claim, the relevant constituency would be barred from pursuing their overlapping claim, but if the company did not then the other constituency would be free to pursue it – as per *Giles* v *Rhind*. As the two BVI companies had not claimed against Sevilleja, here Marex would be free to do so.

Fifth, the weak private law approach only applies to claims held by shareholders. Here, these principles were only triggered where the double recovery applied to a claim from a shareholder. This is grounded in a narrow reading of Lord Millett's approach, but it is not clear why this would only apply to one corporate constituency and not others.[38] Here, again, Marex would win.

Thus under four of the five options available to the court, Sevilleja lost. However, for the clarity of the doctrinal framework in this area, and the interaction of company law and private law more broadly, it was important that the court decided not only if Sevilleja won or lost, but if he lost then for which reason. This issue is one that many jurisdictions grapple with – and there is no universal jurisdiction-neutral solution to the issue.[39]

REFLECTIVE LOSS NOW

The Supreme Court's conclusion that Marex could continue their claim only means that option one was rejected. The judgments disagreed as to which of the other four options should be followed. The majority adopted the 'weak company law' approach (option 3). For the majority, double recovery had nothing to do with the reflective loss rule as it is not inevitable that there will be a corresponding loss to the shareholder arising as a result of a wrong to the company. The majority did not think that the company failing to pursue the matter was relevant. They did not consider that the rule could cause any unfairness,[40] and held that minority shareholders had other remedies available to them.[41] For the majority, the prohibition only applied when faced with losses suffered by shareholders in their capacity as shareholders in which the company had its own claim. Lord Reed's judgment stated '[t]he critical point is that the

38 Technically this could be sub-divided into claims held by shareholders qua shareholder and all claims held by shareholders, but this point has not been elaborated upon.

39 See B. de Jong, 'Shareholders' Claims for Reflective Loss: A Comparative Legal Analysis' (2013) 14 *European Business Organization Law Review* 97; J. Lasák, 'Reflective Loss Regulation: A Czech Anomaly' (2018) 19 *European Business Organization Law Review* 161.

40 For a contrary argument, see Koh, n 20 above, 866-867.

41 *Sevilleja*, n 7 above at [81].

shareholder has not suffered a loss which is regarded by the law as being separate and distinct from the company's loss'.[42] There was no analogous issue for creditors.[43] Thus, for the majority, *Prudential* and Lord Bingham's judgment in *Johnson* were correct, and everything else that arose afterwards was not.[44] For the majority, the prohibition was narrow, and only applied where the company had an actionable loss which reduced the amount that the shareholders would receive as shareholders.[45] It reconciled the pension contributions in *Johnson* as being the method in which the company's profit was distributed to Johnson in a tax efficient way. Had these contributions arisen as a result of employment, or bonus, or to satisfy a debt, then the prohibition would have been avoided. The prohibition's taxonomical grounding, therefore, was purely company law. By casting it weakly, it cut through Tettenborn's knotweed to clarify the normal law of obligations would only be affected in narrow circumstances.

The author agrees with the majority, but they could have gone further and held that no qua shareholder claims were conceptually possible against third parties. This is easily extrapolatable from the position of the majority. A large amount of confusion has arisen in the literature and case law because of generic reference to claims by shareholders.[46] If, instead, the analysis had focused on financial rights deriving from shares, it is submitted that the position would have been clearer. Shareholders do not receive much of a legally enforceable financial right from holding a share. Despite arguments that a shareholder is a 'mere purchaser of income',[47] they do not enjoy a legal right to a dividend. Only accumulated, realised, undistributed profits can be distributed.[48] Courts have struck down transactions which have the effect of circumventing these rules,[49] and held that these rules cannot be disapplied by companies.[50] Shareholders do not even decide whether a dividend should be made if one is technically possible.[51]

The overall result is that receiving a dividend is the same as tipping in a restaurant.[52] Even when a dividend is declared, it promptly becomes a debt payable

42 *ibid* at [83].
43 *ibid* at [84].
44 *ibid* at [89].
45 *ibid* at [89].
46 Examples include *Sevilleja ibid* at [162], [165], [166]; Tettenborn, n 6 above, 186; Lin, n 22 above, 556; Mitchell, n 6 above, 458-460.
47 B.C. Hunt, *The Development of the Business Corporation in England 1800-1867* (Cambridge, MA: Harvard University Press, 1936) 130, as discussed in D.D. Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the Companies Act 1985' (1988) 8 *Oxford Journal of Legal Studies* 55, 60.
48 Companies Act 2006, s 830.
49 For example *Aveling Barford Ltd* v *Perion Ltd* [1989] BCLC 626.
50 For example *Precision Dippings Limited* v *Precision Dippings Marketing Ltd, John Anthony Wynne-Jones and Peter John Leslie David King* 1985 WL 1167741.
51 The Companies Act 2006 is silent, and therefore the company's constitution sets who makes such a decision. The default articles of association state that directors have to initiate any dividend decision – The Companies (Model Articles) Regulations 2008 (SI 2008/3229), Sched 1, para 30 for the rules for private companies, and The Companies (Model Articles) Regulations 2008 (SI 2008/3229), Sched 3 para 70 for public companies.
52 D.J.H. Greenwood, 'The Dividend Puzzle: Are Shares Entitled to the Residual?' (2006) 32 *Journal of Corporation Law* 103, 108.

by the company.[53] As such, a shareholder has no right prior to the declaration of the dividend, and a right qua creditor immediately after the declaration. Should someone interfere with the payment of this debt, then reflective loss will not (following the majority) and should not create a prohibition. Shareholders do not have advanced rights to receive returns on their capital, either: for private companies, being most UK companies by number,[54] transfer is frequently restricted.[55] One of the main features of companies over other business vehicles is their permanence,[56] and minority shareholders normally need some form of ground to wind up the company,[57] making it hard for shareholders to force a liquidation to return the capital of their investment.

Therefore, for private companies, shareholders cannot be said to have any form of entitlement to receive funds from the company, or any ability to sell this uncertain income stream to third parties. As such, statements calling shares 'property which generates income',[58] with any harm to this causing shareholders real loss[59] need to be reviewed in this light. Frequently, the analysis is limited to shares issued on public markets.[60] The capital market prevents restrictions on the ability to freely sell shares,[61] and provides a public market for such sales to take place.[62] Prices of listed shares are based on market expectations,[63] and

53 Contrast *Bond* v *Barrow Haematite Steel Co* [1902] 1 Ch 353, where Farwell J held that there was no right for a shareholder to sue for a dividend in advance of one being declared, with *Re Severn and Wye and Severn Bridge Railway Company* [1896] 1 Ch 559, where Romer J held that, upon its declaration, a dividend became a debt of the company due to the shareholder.

54 Of 4,320,862 companies on the public register as at 31 December 2020, only 6,144 were public companies, see https://www.gov.uk/government/statistics/incorporated-companies-in-the-uk-october-to-december-2020 (last accessed 9 March 2021). Only 1,431 were listed on the London Stock Exchange as at 30 June 2020, see J. Hardman, 'UK Companies listed on the London Stock Exchange as at 30 June 2020 by jurisdiction' 2020 [dataset] University of Edinburgh at https://doi.org/10.7488/ds/2898 (last accessed 16 June 2021).

55 See *In Re Cawley & Co* (1889) 42 Ch D. 209; *Charles Forte Investments Ltd* v *Amanda* [1964] Ch 240.

56 M. Eisenberg, *The Structure of the Corporation, A Legal Analysis* (Washington, DC: Beard Books, 1976) 16; H. Hansmann and R. Kraakman, 'The Essential Role of Organizational Law' (2000) 110 *Yale Law Journal* 387, 413; H. Hansmann, R. Kraakman and R. Squire, 'Law and the Rise of the Firm' (2006) 119 *Harvard Law Review* 1333, 1394.

57 A special resolution (being one passed by 75 per cent of shareholders) can wind up a company – Insolvency Act 1986, s 84(1)(b), otherwise the company needs to be not paying its debts, or a minority shareholder needs to convince the court that it is just and equitable to wind the company up (Insolvency Act 1986, s 122).

58 Mitchell, n 6 above, 459.

59 Koh, n 20 above, 867.

60 'When a person buys a share in a trading company in the market, he pays both for a capital asset (the share itself, which he can sell the next day if he chooses) and for the right to participate in the future commercial performance of the company', *Sevilleja*, n 7 above at [145]. This is based on Mitchell, n 6 above, 459; and Lin, n 22 above, 539-552.

61 Listing Rules – Financial Conduct Authority Handbook, rule 2.2.4 at https://www.handbook.fca.org.uk/handbook/LR.pdf (last accessed 9 March 2021).

62 For example *ibid*, rule 14.2.2, which states a minimum 25 per cent of shares must be in public hands for a standard listing.

63 R.J. Gilson and R. Kraakman, 'The Mechanisms of Market Efficiency' (1984) 70 *Virginia Law Review* 549; L.A. Stout, 'The Mechanisms of Market Inefficiency: An Introduction to the New Finance' (2003) 28 *Journal of Corporation Law* 635; W.H. Beaver, 'Market Efficiency' (1981) 56 *The Accounting Review* 23.

therefore it has been identified that this creates market pressure to provide dividends.[64] As such, the abilities to exit your investment and receive a dividend stream are more likely to occur for such publicly listed companies.

There remains, though, for UK companies,[65] no change to the underlying legal requirements – listed companies face even higher[66] restrictions on paying dividends than private companies. As such, there is never a legal entitlement for shareholders to receive the income stream on which markets predicate their expectation of future profits. Indeed, market prices do not decrease by wrongful acts to the company. Even the most egregious of wrongful act does not cause such a drop – disclosure of such act to the market does.[67] This is why companies are required to disclose matters to the public markets to avoid a false market being created as they are likely to delay disclosure to avoid such price drops.[68] Non-company specific issues, of course, also result in price drops – such as industry-specific concerns, or exchange rate movements.[69] Indeed, recent research suggests that valuation is more likely to be based on the perceived quality of management, rather than linked to assets or liabilities of the company.[70] This demonstrates the artificiality of considering that a shareholder qua shareholder can ever 'lose' something when a wrong is done to a company – it could affect income that they could never have a legal entitlement to, and affect the sentiment others have to the future prospects of the company, which can affect the price at which they would be willing to purchase the share.[71] Company law generally is keen to hold that a shareholder only has the rights expressly

64 D.R. Fischel, 'The Law and Economics of Dividend Policy' (1981) 67 *Virginia Law Review* 699; H.K. Baker and R. Weigand, 'Corporate Dividend Policy Revisited' (2015) 41 *Managerial Finance* 126; V. Brudney, 'Dividends, Discretion and Disclosure' (1980) 66 *Virginia Law Review* 85; F. Black, 'The Dividend Puzzle' (1976) 2 *Journal of Portfolio Management* 5.

65 In the same way as not all UK companies are publicly listed on the London Stock Exchange, not all companies listed on the London Stock Exchange are UK companies – see I. MacNeil and A. Lau, 'International Corporate Regulation: Listing Rules and Overseas Companies' (2001) 50 *International and Comparative Law Quarterly* 787; B.R. Cheffins, 'The Undermining of UK Corporate Governance(?)' (2013) 33 *Oxford Journal of Legal Studies* 503.

66 Companies Act 2006, s 831 provides that a public company cannot make a distribution if its net assets are less than its called up share capital and undistributable reserves.

67 P. Ormrod and K.C. Cleaver, 'Financial Reporting and Corporate Accountability' (1993) 23 *Accounting and Business Research* 431; L. Sealy, 'The Disclosure Philosophy and Company Law Reform' (1981) 2 *The Company Lawyer* 51.

68 P.G. Mahoney, 'Mandatory Disclosure as a Solution to Agency Problems' (1995) 62 *University of Chicago Law Review* 1047; J.C. Coffee, 'Market Failure and the Economic Case for a Mandatory Disclosure System' (1984) 70 *Virginia Law Review* 717.

69 'Investors are exposed to market uncertainty no matter how many stocks they hold.' – F.J. Fabozzi and F. Modigliani, *Capital Markets: Institutions and Instruments* (Englewood Cliffs, NJ: Prentice Hall, 1992), as quoted in E. Avgouleas, *The Mechanics and Regulation of Market Abuse* (Oxford: OUP, 2005) at 51.

70 J.J. Park, 'From Managers to Markets: Valuation and the Shareholder Wealth Paradigm' (2021) 47 *Journal of Corporation Law* (forthcoming).

71 For an example of the disassociation between share price and underlying assets, see the recent GameStop asset bubble caused by reactions to over-exposed short sellers, see J.J. Angel, 'Gamestonk: What Happened and What to Do About it' (2021) SSRN at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3782195 (last accessed 7 May 2021); D. Valiante, 'GameStop: A Tragedy Waiting to Happen' Oxford Business Law Blog, 23 February 2021 at https://www.law.ox.ac.uk/business-law-blog/blog/2021/02/gamestop-tragedy-waiting-happen (last accessed 7 May 2021).

attached to their shares, and as such are unaffected by changes which do not affect those legal rights, but do alter (sometimes dramatically) the enjoyment of those legal rights.[72] It would therefore be incongruous to state that a financial loss qua shareholder in any way constitutes an actionable wrong against third parties when they have no legal right to receive it in the first place.[73]

There are many circumstances in which shareholders can suffer actionable wrongs from third parties. These are not, however, in their capacity as shareholders. Thus in *Johnson*, the solicitors in question also provided advice to Mr Johnson, and that was the ground on which he was able to recover qua advisee;[74] in *Giles* the issue was a shareholder enforcing personal contractual rights held qua contractual counterparty;[75] in *Gardner*, the court should have differentiated between the shareholder's claim qua shareholder, which should have been caught by the prohibition, and their claim shareholder qua creditor, which should not have been. By shifting from who holds the claim, to the type of claim held, additional clarity could have been provided.

Lord Hodge's judgment was more strident, blaming the confusion on the prohibition being co-opted by private law.[76] He identified that shareholders obtained a number of advantages, such as limited liability,[77] and the residual claim in the company.[78] In exchange, though, minority shareholders risk being outvoted, shareholders delegate decisions to the board,[79] and shareholders have to be paid after creditors.[80] On this basis, from a company law perspective, a 'bright line' prohibition is principled to deny that a shareholder qua shareholder suffers any personal loss where the company also does.

The minority disagreed, and instead situated the prohibition squarely in the private law taxonomical grounding, with the fifth option of a weak private law rationale. For the minority, double recovery is the key.[81] A shareholder does not

72 See *White* v *Bristol Aeroplane* [1953] 2 WLR 144, whereby the issue of new shares with a diluting effect was held to not affect the rights attaching to the objecting shareholder's shares, merely their enjoyment of those rights.

73 Shareholders can suffer non-financial loss, such as being excluded from decision making, or not receiving information. Technically, remedies are also restricted under the rule in *Foss* v *Harbottle*, n 3 above; Davies, n 1 above. It is frequently argued that shareholders can circumvent this by raising a personal action against the company to enforce their rights under the articles – see K.W. Wedderburn, 'Shareholders' Rights and the Rule in Foss v Harbottle' (1957) 15 *Cambridge Law Journal* 194; G.D. Goldberg, 'The Controversy on the Section 20 Contract Revisited' (1985) 48 MLR 158.

74 *Johnson*, n 24 above, 36, where Lord Bingham stated of Johnson's first claim that '[t]he claim is for sums which Mr Johnson, acting on GW's advice, invested in these companies and lost. This claim is unobjectionable in principle'.

75 *Giles*, n 33 above at [19]: 'Mr Giles and the company were promisees of the same covenants given independently to each other'.

76 *Sevilleja*, n 7 above at [95]: '[i]n my view the problems and uncertainties which have emerged in the law have arisen because the "principle" of reflective loss has broken from its moorings in company law'.

77 Which he states is 'a consequence of the separate legal personality of the company', *Sevilleja*, n 7 above at [102]. This is incorrect – see discussion in J. Hardman, 'Reconceptualising Scottish Limited Partnership Law' (2021) 21 *Journal of Corporate Law Studies* 179, 211.

78 *Sevilleja*, n 7 above at [105].

79 *ibid* at [107].

80 *ibid* at [108].

81 *ibid* at [119].

agree, according to the minority, to 'stay his hand as regards vindication of his personal rights of action against a defendant to safeguard theirs'.[82] Thus Lord Sales states that a third party can owe 'obligations in contract or tort'[83] to a shareholder, and breach of this obligation can reduce the shareholder's income or the value of their shares. The examples deployed are *Lee* v *Sheard*[84] (*Lee*) (where a company's director and shareholder was run over, and so lost dividends), *George Fischer (Great Britain) Ltd* v *Multi Construction Ltd*[85] (*George Fischer*) (where a parent company hired someone to build a warehouse for its subsidiary, and when that was done negligently, the value of the subsidiary reduced), *Gerber Garment Technology Inc* v *Lectra Systems Ltd*[86] (*Gerber*) (where a parent company held intellectual property rights, and infringement hurt the subsidiary, and the value of the subsidiary reduced), *Barings plc* v *Coopers & Lybrand*[87] (where a parent company hired an auditor, for the parent's own regulatory purposes, to audit the entire group, and a faulty audit lowered the value of the subsidiary) and the New Zealand case of *Christensen* v *Scott*[88] (where shareholders had guaranteed the debts of the company, and a wrong to the company reduced the value of their shareholding). None of these originated qua shareholder – instead arising qua tort victim, qua contractual counterparty, qua intellectual property holder, or qua guarantor. As these harms did not arise to the shareholder qua shareholder, even the majority would agree that the prohibition was not triggered for most heads of claim under such breaches.

Some heads recovered were qua shareholder. The majority tried to reconcile *Lee* as the company suffered no wrong, only the shareholder, and so the prohibition was irrelevant.[89] However, following Lord Hodge's judgment, it would have been neater had they sided with the argument of the wrongdoer's counsel in *Lee* when they argued if a shareholder chose to use a corporate form, they had to suffer downsides of such corporate form, such as the prohibition applying to any qua shareholder losses.[90] This would be even clearer and brighter. It has been argued that such a clear bright line risks unfairness.[91] However, any risk of unfairness can only arise as a result of a deliberate choice to utilise the corporate form. In each of these cases, a deliberate choice had been made to structure shareholder income by way of dividend rather than employment,[92] or to create a subsidiary[93] or to incorporate a company rather than use a partnership form.[94] Each choice is normally deployed due to an advantage for the shareholder.[95] The reasoning of Lord Hodge is persuasive – obtaining

82 *ibid* at [125].
83 *ibid* at [128].
84 n 27 above.
85 n 27 above.
86 n 27 above.
87 [1997] 1 BCLC 427.
88 [1996] 1 NZLR 273.
89 *Sevilleja*, n 7 above at [44].
90 *Lee*, n 27 above.
91 *Sevilleja*, n 7 above at [150] and [167]; Watts, n 6 above.
92 For *Lee*, n 27 above; *Johnson*, n 24 above.
93 For *George Fischer*, n 27 above; *Gerber*, n 27 above; *Barings*, n 87 above.
94 For *Giles*, n 33 above; *Christensen* v *Scott*, n 88 above.
95 For the choice of income being routed by way of employment income, see J. Prassl, 'Employee Shareholder "Status": Dismantling the Contract of Employment' (2013) 42 *Industrial Law Journal*

such private advantages should carry an inherent risk, and it is wrong to consider such quid pro quo unfair.

THE AUTONOMY OF COMPANY LAW

The majority's taxonomical grounding provides four important implications for company law as an academic discipline. First, it strengthens the autonomy of company law. Academic discourse has concentrated on identifying company law as a standalone area of legal analysis.[96] Yet, paradoxically,[97] most company law theories derive from private law concepts. Thus arguments exist that holding a share provides a series of contractual rights,[98] property rights,[99] and/or a mixture of property rights and contractual rights.[100] In each case, a share is reducible to a series of private law rights. If so, then we must question must whether company law is actually autonomous, or merely an interlocking series of private law rules. If the latter, company law could be drastically changed, in unintended ways, by legal developments in these private law concepts which ostensibly are unrelated to company law.[101]

If the minority had carried the day, and the prohibition was merely a part of the law of obligations and only relevant where there is double recovery, then the prohibition is purely a matter of private law. Other commentators have identified that this decision returned the prohibition to company law.[102] Even further, though, it boosted the autonomy of company law as it means a share provides a series of company law entitlements to a shareholder. The case illustrates, however, that trying to fit these company law concepts within the private law taxonomical framework risks causing confusion.

307; use of a corporate group is normally driven by choices to minimise liability – see R. Squire, 'Strategic Liability in the Corporate Group' (2011) 78 *The University of Chicago Law Review* 605, and similarly the use of the corporate form over partnership is likely to be driven to minimise personal liability – see R.A. Booth, 'Limited Liability and the Efficient Allocation of Resources' (1994) 89 *Northwestern University Law Review* 140.

96 See for example the leading text, R. Kraakman et al, *The Anatomy of Corporate Law* (Oxford: OUP, 3rd ed, 2017) which implies, in its title, a singular whole to explore the anatomy of. The narrative often states that market pressure will force convergence of any remaining doctrinal differences – see H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2000) 89 *The Georgetown Law Journal* 439.

97 Indeed, company law contains a number of paradoxes, see M.T. Moore, 'Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism' (2014) 34 *Oxford Journal of Legal Studies* 693.

98 For example F.H. Easterbrook and D.R. Fischel, 'The Corporate Contract' (1989) 89 *Columbia Law Review* 1416.

99 For example J. Armour and M.J. Whincop, 'The Proprietary Foundations of Corporate Law' (2007) 27 *Oxford Journal of Legal Studies* 429.

100 R. Grantham, 'The Doctrinal Basis of the Rights of Company Shareholders' (1998) 57 *Cambridge Law Journal* 554; R.C. Nolan, 'Shareholder Rights in Britain' (2006) 7 *European Business Organization Law Review* 549.

101 See discussion for this interaction between Scots and English law in J. Hardman, 'Further Legal Determinants of External Finance in Scotland: an Intra-UK Market for Incorporation?' (2021) 25 *Edinburgh Law Review* 192.

102 See A. Tettenborn, 'Less law is good law? The taming of reflective loss' (2021) 137 *Law Quarterly Review* 16; Davies, n 1 above.

Second, this autonomy is not endless. A strong company law outcome would have meant company law's boundaries are wide, and could interfere with the general law of obligations where a company interacts with the outside world. No judgment in this case advocated this. Instead, here the role of company law was narrowed to the interaction between the company and the shareholder qua shareholder. Whatever other rights a shareholder may hold will not be affected by this area of company law. There is a risk that this may expose third parties to opportunistic moves by shareholders in their other capacities. Perhaps the autonomy of company law has been won at the expense of its scope.

Third, there is often a debate about the role of shareholders within companies.[103] It is argued that they should have enhanced rights in the company compared to other constituencies,[104] and descriptively it is often claimed that they do.[105] As all judgments adopted weak approaches rather than strong approaches, the special place of shareholders is reinforced. As Lord Hodge pointed out, shareholders obtain certain benefits from the corporate form.[106] It is, therefore, right for company law theory to treat shareholders as distinct from other constituencies and so to have a special place in the theoretical framework for corporate law.

Fourth, this special place has disadvantages for shareholders. In exchange for those benefits, again as Lord Hodge identified, shareholders have disadvantages.[107] The majority judgment repeatedly stated that the appropriate remedy for minorities was a derivative claim,[108] relief under the equally-criticised[109] unfair prejudice regime,[110] or to convince a court that it is just and equitable to wind the company up.[111] Thus a qua shareholder claim is materially disadvantaged compared to the claims arising in other capacities when interacting with the company: the law now acknowledges that all other capacities have the claim, whereas shareholders are precluded from being considered to even

103 This is often phrased in terms of the company's purpose – whether it should be run to maximise the financial interests of shareholders alone (for example D.G. Smith, 'The Shareholder Primacy Norm' (1998) 23 *The Journal of Corporation Law* 277), or whether other constituents should be considered, see D. Attenborough, 'Giving purpose to the corporate purpose debate: an equitable maximisation and viability principle' (2012) 32 *Legal Studies* 4. Variations of this discussion arise in respect of both the appropriate 'ends' and also the appropriate 'means' to achieve those ends – see S.M. Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford: OUP, 2008).

104 For example it is often claimed that as shareholders hold the 'residual claim' on winding up, they are the appropriate constituency to vote on major matters (F.H. Easterbrook and D.R. Fischel, 'Voting in Corporate Law' (1983) 26 *Journal of Law and Economics* 395) and be the ultimate recipient of fiduciary duties (J.R. Macey, 'An economic analysis of the various rationales for making shareholders the exclusive beneficiaries of corporate fiduciary duties' (1991) 21 *Stetson Law Review* 23).

105 For example to discipline directors – see A. Keay, 'Company directors behaving poorly: Disciplinary options for shareholders' [2007] *Journal of Business Law* 656.

106 *Sevilleja*, n 7 above at [105].

107 *ibid* at [107] and [108].

108 *ibid* at [71], [81] and [83].

109 See discussion in J. Hardman, 'The Plight of the UK Private Company Minority Shareholder' (2022) *European Business Law Review* (forthcoming).

110 It has been argued that this regime ultimately operates to subvert the prohibition on reflective loss – see A.K. Koh, 'Reconstructing the reflective loss principle' (2016) 16 *Journal of Corporate Law Studies* 373.

111 *Sevilleja*, n 7 above at [34].

have such a claim qua shareholder unless the company has no claim. Thus, the special nature of shareholders provides a double edged sword for them: it may justify shareholders voting on material corporate affairs,[112] but does so to the exclusion of remedies to them.

Thus for company law and shareholders, the case offers good and bad news. Company law's autonomy is boosted at the expense of its scope. Shareholders are special, which can hurt them. Most analysis, though, is unrelated to Marex's claim against Sevilleja: no matter which judgment was followed, Marex could continue their claim. The disagreements between the judgments transcended the facts of the case, but are of much greater interest.

112 For example Easterbrook and Fischel, n 104 above.